

FIVE SECRETS FOR SUCCESSFULLY NEGOTIATING A COMMERCIAL OR RETAIL LEASE

By Robert Chavez, Founder and CEO of Guardian Commercial Realty

Most commercial tenants consider leases to be an administrative hassle. The faster they can move through the irritating paperwork, the faster they can move on with business. But with real estate overhead the second-most expensive line item for businesses, negotiating leases should not be taken casually, particularly for commercial tenants renewing their commitments for an additional five or ten years.

New terms driven by market conditions and imposed by aggressive landlords can increase a company's rent and related expenses by more than 50 percent at each renewal. Landlords attempt to impose all costs, risks, and inflated profits to their commercial tenants, and most tenants simply sign on the dotted line, quickly committing to long-term, expensive leases in exchange for few and minor concessions.

Why the haste to sign an agreement that is so clearly weighted in favor of the landlord and not the tenant? Dissecting this phenomenon requires an understanding of the dynamics and relevant issues related to negotiating leases.

Consider that a finite list of alternatives is available to tenants when it comes to their workspaces. They can:

- 1) Renew their existing lease;
- 2) Relocate and lease space in a different building;
- 3) Relocate and purchase a building; or
- 4) Work from home (an option that is becoming more and more feasible in today's technology-rich environment).

Some tenants view the expiring lease as an exciting opportunity to move, but most dread the time and costs related to a corporate relocation. Ironically, in their haste to avoid expense and frustration, this latter group often makes the most costly mistake when addressing their lease renewals: they fail to leverage their alternatives.

When negotiating lease extensions, tenants focus on the expenses and logistics that impact their company's direct profits. They pay close attention to their personal costs related to rent, construction, moving, technology, space planning, and lost productivity. Though these considerations should certainly be on the list, most tenants fail to recognize the tremendous cost and risk faced by landlords when a tenant vacates a property. Failing to leverage this fact, as well as available office space alternatives, puts the tenants at a tremendous disadvantage when it comes time to negotiate their leases.

Focusing only on tenant-related costs militates in favor of staying-put. Landlords like it this way: this strategy allows them greater leverage to charge inflated rates while offering nominal concessions. In exchange for paying higher rent, tenants accept new carpet, minimal rent

abatement, and a fresh coat of paint as suitable reasons to avoid moving.

Instead, they should take a more strategic approach by following five basic steps for negotiating a commercial lease.

1. **Quantify the costs faced by the landlord if the tenant vacates.**

When negotiating a lease, particularly a renewal, consider the time the landlord must expend to lease space to a new tenant as well as the improvement costs necessary to retrofit space for a new tenant.

Construction costs, including space planning and permitting for a modest retrofit, cost conservatively \$20 per square foot. Add the cost associated with the landlord's time preparing, advertising, and negotiating a 10,000-square-foot space, and the immediate cost to the landlord becomes apparent and staggering: it typically ranges from \$450,000 to \$600,000, or \$45 to \$60 per square foot. Compare this to the \$6 to \$9 concession package to which most renewing tenants agree.

Understanding this math puts the tenant at an advantage. Because a commercial space usually does not produce revenue for nine months after a tenant vacates, a tenant renegotiating a lease can generally bargain for much more than a new paint job and a few minor frills.

The key is to recognize that landlords are always more nervous about the time, money, and risk associated with vacant space than they acknowledge.

2. **Ignore bullying tactics.**

Landlords know that an expert real estate professional will educate the tenant and ultimately cost the landlord revenue. To avoid this, landlords often approach their tenants early and propose two sets of lease terms: the first proposes a lower rate if the tenant is not represented by a broker; the second imposes higher rent for broker-negotiated deals. The landlord blames the extra cost of the latter on commission fees, but the truth is that brokers can negotiate much better terms than either scenario offered by the landlord.

In fact, hiring a broker might be smarter than simply employing legal counsel. Though company lawyers understand the law, they are generally not experts in real estate terms and concessions available in a particular marketplace. Assuming that company counsel will ensure the proper protection and safeguards usually means the tenant will fail to benefit from terms that otherwise would have been available if an expert real estate professional also had been involved early in the process.

3. **Conduct due diligence.**

It matters not whether a tenant is relocating or negotiating a lease extension: conducting due diligence of market conditions is critical even for tenants with no desire to relocate. Knowledge of the quality, quantity, and cost of relocation opportunities provide leverage for the tenant when negotiating with their current landlord, as does knowing the length of time commercial spaces generally remain vacant.

Understand the true logistics of your office space needs. Different companies have different space requirements. Likewise, building floor plates come in many different shapes and sizes. Not all tenants fit efficiently into all buildings. A large insurance company might fit well in a 70,000-square-foot floor, but the same large floor could be extremely inefficient for a 10,000-square-foot mortgage company. Understanding the intricacies of a floor's layout can be complicated, so use your broker and architect early in the process to assist in determining which building is most efficient for your company's needs. In many instances, an appropriate floor size and shape can reduce a tenant's square footage by 10 to 15 percent. Over five years, this translates to an approximate \$180,000 savings for a 10,000-square-foot tenant.

Tenants must also exercise care when selecting a commercial real estate broker to represent their interests. Critical to the process is hiring a broker from a real estate firm that exclusively represents tenants. Most firms and brokers derive the bulk of their revenue from representing landlords in the managing, leasing, selling, and refinancing processes. With their livelihoods so closely aligned with landlords, these brokers will seldom, if ever, aggressively negotiate on behalf of a tenant. True tenant brokers will not accept work from landlords, thereby avoiding a conflict of interests and the appearance of impropriety.

Interview several tenant brokers and make your selection based on experience, references, and chemistry. Be certain that the broker presenting the services is more than a marketing expert and will be the broker personally handling your assignment.

4. Consider the true cost.

In their effort to focus on the companies' core business, tenants often fail to recognize the true costs. Failure to properly negotiate a lease can cost a 10,000-square-foot tenant \$300,000 over the course of a five-year lease, and often even more. In addition to the rental rate, tenants should consider items such as square footage calculations, option language for future expansions and extensions, detailed landlord responsibilities, appropriate base year calculations, tax protection, and exclusions from operating expenses. Just a few of many issues that can cripple a tenant if not properly negotiated, these terms are often foreign to most tenants who address leases infrequently, another reason an expert tenant broker can benefit the commercial lessee.

5. Take the initiative.

Most tenants wait far too long to address the issues related to their expiring leases, simply ignoring the issue until the landlord initiates a conversation. But conducting the due diligence necessary to effectively negotiate leverage takes at least eighteen months. The entire process should be finalized no later than six months prior to lease expiration, which means the tenant should start addressing lease negotiations two years before the expiration date.

Be proactive about negotiating your lease and send a clear message to your landlord: you have committed the time, energy, and resources necessary to secure the best terms for

your commercial office space needs. This is not the only game in town, and your landlord must consider your needs—or another landlord will.

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